

Property A, nondepreciable real property with a fair market value of \$10,000 and an adjusted tax basis of \$1,000. B contributes Property B, nondepreciable real property with a fair market value and adjusted tax basis of \$10,000. The partnership also borrows \$10,000 on a recourse basis and purchases Property C. The \$10,000 liability is allocated equally between A and B under section 752, thereby increasing the adjusted tax basis in A's partnership interest to \$6,000.

(ii) On December 31, 1998, the partners agree that A is to receive Property B in a current distribution. If A were to receive Property B at that time, A would recognize \$4,000 of gain under section 737, an amount equal to the lesser of the excess distribution of \$4,000 (\$10,000 fair market value of Property B less \$6,000 adjusted tax basis in A's partnership interest) or A's net precontribution gain of \$9,000 (\$10,000 fair market value of Property A less \$1,000 adjusted tax basis of Property A).

(iii) With a principal purpose of avoiding such gain, A and B agree that A will be solely liable for the repayment of the \$10,000 partnership liability and take the steps necessary so that the entire amount of the liability is allocated to A under section 752. The adjusted tax basis in A's partnership interest is thereby increased from \$6,000 to \$11,000 to reflect A's share of the \$5,000 of liability previously allocated to B. As a result of this increase in A's adjusted tax basis, there is no excess distribution because the fair market value of distributed Property B (\$10,000) is less than the adjusted tax basis of A's partnership interest. Recognizing A's increased adjusted tax basis as a result of the shift in liabilities is consistent with the purpose of section 737 and this section. Section 737 requires recognition of gain only when the value of the distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. The \$10,000 recourse liability is a bona fide liability of the partnership that was undertaken for a substantial business purpose and A's and B's agreement that A will assume responsibility for repayment of that debt has substance. Therefore, the increase in A's adjusted tax basis in A's interest in the partnership due to the shift in partnership liabilities under section 752 is respected, and A recognizes no gain under section 737.

[T.D. 8642, 60 FR 66738, Dec. 26, 1995]

§ 1.737-5 Effective date.

Sections 1.737-1, 1.737-2, 1.737-3, and 1.737-4 apply to distributions by a partnership to a partner on or after January 9, 1995.

[T.D. 8642, 60 FR 66739, Dec. 26, 1995]

TRANSFERS OF INTERESTS IN A PARTNERSHIP

§ 1.741-1 Recognition and character of gain or loss on sale or exchange.

(a) The sale or exchange of an interest in a partnership shall, except to the extent section 751(a) applies, be treated as the sale or exchange of a capital asset, resulting in capital gain or loss measured by the difference between the amount realized and the adjusted basis of the partnership interest, as determined under section 705. For treatment of selling partner's distributive share up to date of sale, see section 706(c)(2). Where the provisions of section 751 require the recognition of ordinary income or loss with respect to a portion of the amount realized from such sale or exchange, the amount realized shall be reduced by the amount attributable under section 751 to unrealized receivables and substantially appreciated inventory items, and the adjusted basis of the transferor partner's interest in the partnership shall be reduced by the portion of such basis attributable to such unrealized receivables and substantially appreciated inventory items. See section 751 and § 1.751-1.

(b) Section 741 shall apply whether the partnership interest is sold to one or more members of the partnership or to one or more persons who are not members of the partnership. Section 741 shall also apply even though the sale of the partnership interest results in a termination of the partnership under section 708(b). Thus, the provisions of section 741 shall be applicable (1) to the transferor partner in a 2-man partnership when he sells his interest to the other partner, and (2) to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

(c) See section 351 for nonrecognition of gain or loss upon transfer of a partnership interest to a corporation controlled by the transferor.

(d) For rules relating to the treatment of liabilities on the sale or exchange of interests in a partnership see §§ 1.752-1 and 1.1001-2.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7741, 45 FR 81745, Dec. 12, 1980]